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# Sold out juniors on the same property: National Enters. v Woods, 2001

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### Recommended Citation

Bernhardt, Roger, "Sold out juniors on the same property: National Enters. v Woods, 2001" (2001). *Publications*. Paper 365.  
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## **Sold out juniors on the same property:**

### ***National Enters. v Woods, 2001***

**Roger Bernhardt**

**After creditor holding senior and junior loans secured by same property sold loans to independent parties, CCP §726(a)'s "one form of action" rule did not bar sold-out junior lienholder's suit for deficiency following senior lienholder's judicial foreclosure.**

*National Enters., Inc. v Woods* (2001) 94 CA4th 1217, 115 CR2d 37

The bank made two loans to a borrower, one in 1986 and one in 1988, which were secured by deeds of trust on the same property. The trust deeds contained a dragnet clause which provided that "at lender's option . . . future advances to borrower . . . shall be secured by this instrument when evidenced by promissory notes stating that said notes are secured thereby." The bank failed and the borrower defaulted; the bank's receiver sold the loans to two independent parties. After the senior lienor judicially foreclosed its deed and sold the property (which exhausted the security), the junior lienor (NEI) sued the borrower for nonpayment, seeking a deficiency judgment. The trial court found that the first and second deeds had merged because of the dragnet clause, and, with the foreclosure of the senior deed, NEI was barred from any further collection on its junior note under the one-action rule of CCP §726(a).

The court of appeal reversed. The court rejected the application of merger on several grounds, including the fact that it would be contrary to the language of the loan documents. The junior note expressly identified the second deed of trust as the applicable security instrument; furthermore, the dragnet clause in the first deed provided for inclusion of future indebtedness "at lender's option," and that option had not been exercised.

Also, §726(a)'s "one form of action" rule does not prohibit separate actions to recover separate debts assigned to independent parties, even if the debts are related (*e.g.*, secured by the same property). Otherwise, different creditors holding separate debts would be required to join in a single action, simply because the debts were once held by a single creditor. The court also found that (94 CA4th at 1234)

section 726's purpose of compelling the exhaustion of all security before the entry of a deficiency judgment is not thwarted if an independent junior lienholder is permitted to bring an action after the senior lienholder has exhausted the security. In such an instance, the security has already been exhausted, and no purpose would be served in requiring the junior lienholder to go through a meaningless foreclosure procedure.

The court buttressed its decision by citing the adverse effect a contrary holding would have on the dynamics of the secondary mortgage market, which provides "new sources of mortgage capital, moderation of the cycles of a downturn in the availability of capital, and a flow of capital from areas with a surplus to areas with greater demand than available capital." 94 CA4th at 1236.

►**THE EDITOR'S TAKE:** Secondary mortgage market participants can certainly sleep more easily in light of this decision. Had it gone the other way, they would have run the risk that their mortgages might be merged or destroyed by the actions of a stranger because at some earlier

time another mortgage on the same property had been held by the same institution. Now, that fear is mostly dissipated.

The two mortgages in this case, executed two years apart, were sold off before the creditor (by then the RTC) had taken any action to collect or enforce either one of them (although the facts are unclear as to whether they were not already in default at the time). This circumstance of two independent assignees makes it possible for another court to reach different results in different situations. For example, would a transfer of one mortgage, made after the other one was already in foreclosure, constitute a “scheme to circumvent the rule,” which the court says could produce a different result? There is also the risk that a differently drafted dragnet clause could put together what has here been rent asunder.

On a separate aspect, I cannot help but note with amusement the irony of construing the one-action rule to justify the idea that two separate actions can be maintained against the same mortgagor. The first mortgagee foreclosed judicially, which undoubtedly entailed joining the second mortgagee as a party defendant, who therefore certainly could have cross-complained for the money judgment it ultimately obtained in its later independent action. If we take seriously the notion that a major purpose of the rule is to shield a mortgagor from the harassment that results from dealing with a multiplicity of actions, then it seems to me that that purpose would be directly furthered by requiring the junior mortgagee to assert its claims in the senior foreclosure action in which it has already been included. The junior may lose control over the timing of its own remedy, but that is a risk all juniors take with regard to senior behavior. It is unnecessary for a joined junior to cross-complain for foreclosure in that senior action, but the junior ought to be able to pray both for the surplus after a senior sale and for an independent money judgment as a sold-out junior, without having to file a separate action, which inconveniences everybody. But that sort of result would require us to really think about why we have a one-action rule in the first place, which is not something we are likely ever to do. —*Roger Bernhardt*